

A Tax Break for LTC Hybrids

Pay for long term care without paying taxes on an annuity withdrawal.

provided by *Benedict A. Mitchell Jr.*

A tax break with an additional benefit. Did you know that, since taking effect in 2010, you are allowed to withdraw money from a certain kind of annuity without paying taxes as long as you use it to pay for qualified long term care coverage? A tax break for these important savings will be of interest to many thinking about the future, especially those in the highest tax bracket. This break originates from the Pension Protection Act of 2006.¹

What is a LTC Hybrid? No, it's not a car; though just as hybrid vehicles combine gasoline and electric power, an LTC Hybrid combines two functions within the same policy. A hybrid annuity is a non-qualified deferred annuity structured to provide either a long-term care benefit or a death benefit. It can be a less expensive alternative to a traditional LTC policy.¹

Before the change in law, you could make a withdrawal from these hybrid annuities without facing penalties or surrender charges – but part of the withdrawal could be subject to tax. Since 2010, any withdrawal from such an annuity is income tax free if the money goes toward qualified long term care. For example, if the \$100,000 you initially put into a hybrid annuity with an LTCI rider has grown to \$250,000, you can pull the entire \$250K out without a tax hit if that \$250K will be used to pay for qualified LTC coverage. You wouldn't even pay taxes on the \$150,000 gain of the annuity.^{1,2}

If you are simply withdrawing small amounts from a hybrid annuity annually to help pay for LTC, those tax-free withdrawals will be taken from the principal of the hybrid annuity and not the gain of the annuity. That is by law under the new tax treatment.¹

A tax-sheltered exchange into a hybrid annuity? Sure. The Pension Protection Act also allows you to make a 1035 exchange into a hybrid annuity (as long as the insurer offering the LTC Hybrid accepts 1035 exchanges). So you can exchange an annuity you have now for one with an LTC rider that would permit you to withdraw the entire value of the annuity to pay qualified long term care costs - tax-free and penalty-free.³

Could an LTC hybrid prove useful to you? Are they suitable for your overall financial picture? You might want to contact your insurance or financial advisor to take a closer look at them and the potential tax break they could offer you.

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Citations.

1 - kitces.com/blog/is-the-ltc-cost-guarantee-of-todays-hybrid-lifeltc-or-annuityltc-insurance-policies-just-a-mirage/ [10/16/13]

2 - elderlawanswers.com/long-term-care-hybrid-products-give-buyers-more-options-7812 [3/21/14]

3 - ltcindiana.com/blog/long-term-care-insurance-or-lifeannuity-ltc-hybrid [5/24/13]